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C O N F I D E N T I A L SECTION 01 OF 03 KUWAIT 001600

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STATE FOR NEA/ARP, EB; TREASURY FOR JONATHAN ROSE

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TAGS: [EFIN](#) [EPET](#) [EINV](#) [KU](#) [IR](#)

SUBJECT: TREASURY U/S MCCORMICK DISCUSSES SOVEREIGN WEALTH
FUNDS, GCC, IRAN, NOPEC WITH GOK, BANKS, INVESTORS

REF: A. KUWAIT 1562

[B](#). STATE 148605

[C](#). KUWAIT 1422

Classified By: CDA Alan G. Misenheimer for reasons 1.4 (b) and (d)

[1](#)1. (C) Summary: On October 28, a U.S. Treasury delegation led by Under Secretary for International Affairs David H. McCormick met with the Kuwait Investment Authority (KIA), the Central Bank of Kuwait (CBK), the Finance Minister, and the Public Institution for Social Security (PIFSS) to discuss the current U.S. economic situation, open investment and the designation, as announced by Secretaries Rice and Paulson, of several Iranian entities for their support of terrorism and proliferation. McCormick said the underlying fundamentals of the U.S. economy are encouraging despite current problems in the housing sector. He referred to the President's open investment policy and encouraged the GOK to continue to invest in the U.S. and to improve the climate for foreign investment in Kuwait. (Comment: In a private dinner on October 27, Kuwait Petroleum Corporation (KPC) General Counsel Shaykh Nawaf Saud Nasir Al Sabah said NOPEC was a major concern and Kuwaiti investment in a U.S. refinery was unlikely because of formidable regulatory challenges. End Comment) McCormick promoted the development of a set of best practices for Sovereign Wealth Funds (SWFs) to minimize the risk of a protectionist backlash. The Kuwaitis seemed willing to discuss this further, although the (now former) Minister of Finance and the Managing Director of KIA were suspicious that the U.S. approach conceals a protectionist agenda. (Note: The GOK announced the appointment of a new technocrat Finance Minister, Mustafa Al-Shamali, as part of a Cabinet reshuffle. See Ref A.)

[1](#)2. (C) Regarding GCC monetary union, the Kuwaitis indicated that this was still desirable but not likely to happen by the 2010 target. GOK officials also said they remain committed to the exchange rate basket. McCormick urged the GOK to put pressure on Iran to take action against terrorist activities, and Kuwaiti officials affirmed that Iranian banks do not operate in Kuwait. End Summary.

U.S. Economy, Open Investment, SWF Best Practices

[1](#)3. (SBU) On October 28, a U.S. Treasury delegation led by Under Secretary for International Affairs David H. McCormick met separately with KIA Managing Director Bader Al-Saad, CBK Deputy Governor Dr. Nabeel Al-Mannae, (then) Finance Minister Bader Al-Humaidhi (who has since been replaced by former Finance Assistant Under Secretary Mustafa Al-Shamali), and PIFSS Director Fahed Al-Rajaan to discuss the current U.S. economic situation, open investment and the designation

of several Iranian entities for their support of terrorism and proliferation.

14. (SBU) McCormick emphasized that despite the problems in the housing sector the underlying fundamentals of the U.S. economy are encouraging. The economy is sound, retail sales are up, inflation is well in hand and corporate profits are solid. He noted that although the housing market continues to suffer, the growth of emerging capital markets offsets the loss from the housing sector. McCormick emphasized that the U.S. remains open to foreign investment and referred to the President and Secretary Paulson's statements on open investment and trade.

15. (SBU) On SWFs, McCormick remarked that their profile has grown as the number and net worth of funds have exploded. He cautioned that perceptions differ from the facts and that it is important to educate people so they understand that there are no risks. Otherwise, it may be difficult to counter the protectionist sentiments that are clearly on the rise in the OECD countries and Asia, as evidenced by recent reporting in the financial and popular press, as well as new legislative initiatives. McCormick suggested that the development of a set of voluntary, flexible best practices for SWFs would help manage these pressures, and noted that a similar effort for hedge funds appeared to have quelled demands by European officials for regulatory oversight of the hedge fund industry.

Finance Minister: What's the next step for SWFs?

16. (C) Finance Minister Al-Humaidhi said that he is still

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unclear on what the IMF's intentions are concerning SWFs and best practices. Everyone wants to know what the next step will be; this remains unclear to the GOK and the Gulf Cooperation Council (GCC). (Comment: The Kuwaitis apparently perceived former MD De Rato as vague on this point during a discussion at the recent meeting of GCC finance officials. End Comment). The Finance Minister said that GCC officials want to know what the next step will be, but this remains unclear. He said he did not want to take any action until he had clearer guidance on how to proceed, and he was not convinced the U.S. had thought through the steps for developing a set of best practices. McCormick noted that he was not proposing specifics because the U.S. was often criticized for doing things unilaterally, and wants this to be a collaborative effort. He also suggested that this initiative should not pose problems for the mature and well developed funds, as it is likely they already use best practices.

17. (C) On the question of a GCC common currency, Al-Humaidhi said the view of the GCC and GOK is that 2010 is not an attainable target. At least three or four countries need more time and the GCC is willing to accommodate their request. He also said that Kuwait's move to a currency basket has been good for Kuwait, noting that the currency had since appreciated by 4 percent against the dollar.

Pension Fund: Kuwait not utilizing investment opportunities

18. (C) PIFSS Director General Al-Rajaan boasted that his pension system is "the best in the world" and that all of its assets are managed externally. On the country's investment outlook more broadly, Al-Rajaan said, "Kuwait is not making the best use of its investment opportunities and is not active enough in direct investment." He said if the GOK would invest long-term it could turn 200 billion into 500 billion. He compared this to the 1980's, when he said the Kuwaiti leadership supported a much more high profile

investment strategy.

¶9. (SBU) Al-Rajaan also said he is not concerned with the problems in the U.S. housing market, and he is convinced that the U.S. will continue to show growth, noting that it has a dynamic and resilient economy. Nor did he seem concerned about the investment environment in the United States. Al-Rajaan said he prefers to invest in the emerging markets and the best way to invest in those markets is through U.S. funds. He noted that 90% of PIFSS investments are managed by U.S. companies, and encouraged U/S McCormick to visit PIFSS' management office in New York, which has almost USD 5 billion in assets.

KIA willing to talk, but not convinced

¶10. (C) Kuwait Investment Authority (KIA) Managing Director Al-Saad expressed considerable skepticism about the SWF initiative, saying there is no clear consensus among the G-7 countries on what the concerns are. He suggested taking a bilateral approach based on reciprocity. He also noted that SWFs do not cause instability, pointing out that they are focused on long-term returns, which is why they were not affected by the sub-prime market fallout. He also asked, "If GOK funds are going to be regulated thru the G-7 what will be in it for Kuwait?" Further, he pressed on whether the USG was prepared to regulate CALPERS (California's pension system) or other state funds. He also argued that U.S. concerns were being driven by China, and Germany's concerns by Russia.

¶11. (C) McCormick said that SWFs could be put in a broader context to include pension funds and even SOEs, like Gazprom, noting that one of the concerns is "de-privatizing" countries through the purchase of private companies by government-owned entities. He also cautioned that doing nothing- which could lead to new investment barriers - is not an option, and noted that "what's in it for you" is to keep markets open. A reciprocal approach, he cautioned, would simply lead to the erection of new barriers. On this point, McCormick noted that the U.S. feels that maintaining an open investment climate is always in our interest, regardless of other countries' policies. McCormick also stressed that "the idea is not to put anyone on the spot," but to create a process where the "top quartile" of SWFs in terms of best practices, and the idea is to get others to be more like KIA.

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¶12. (C) McCormick also noted that investments posing national security concerns fall into a relatively small category, and reported that the OECD is working to narrow this definition to prevent policies in this area from getting more rigid. Going forward, McCormick emphasized it would be important to hear from the IMF's new Managing Director and to keep channels of communication open.

CBK supports development of best practices

¶13. (C) Central Bank Deputy Governor Al-Mannae was more positive about working with the IMF to create a set of SWF best practices, although he cautioned that creating best practices based on the concerns of Germany and other European countries would be excessive. McCormick noted there is a risk of getting criticized for defining - or not defining - what these best practices should be. However, he stressed that he wants the SWFs "to have a seat at the table". Al-Mannae said he was going to a meeting in Shanghai where sovereign wealth funds are on the agenda, and that they are "everywhere." He said that he is open to further dialogue on the subject but is keen to know exactly what is on the table.

¶14. (C) Al-Mannaie asked McCormick where he saw the dollar going. McCormick said that currency valuations should be driven by the fundamentals of the market and the Secretary speaks on the dollar and that he has advocated a strong dollar policy. McCormick asked about GCC monetary union. Al-Mannaie said that although everyone is convinced that a monetary union is better in the long-term, monetary integration is not an end in itself. He said that 2010 was an overly ambitious goal, but did not venture an estimate of when GCC monetary union might become possible.

Iranian Designations

¶15. (SBU) McCormick took the opportunity to discuss the recent FATF statement and the designation of several Iranian entities, individuals, and banks for their support of terrorism and proliferation (Ref B). He explained to his interlocutors that the U.S. is fully committed to a diplomatic solution with Iran but remains concerned with Iran's proliferation activities. He urged the GOK officials he met with to take steps to isolate these entities from the international financial system to prevent further facilitation of Iran's proliferation and terrorist activities. GOK officials stressed that there are no Iranian bank branches operating in Kuwait, and Deputy Governor Al-Mannaie noted that they circulated the new U.S. list to all banks in Kuwait and expected them to immediately stop dealing with named banks.

Comment

¶16. (C) Though still somewhat skeptical, the Kuwaitis are willing to engage in further dialogue on SWF best practices. The KIA Managing Director and the (now former) Finance Minister seemed to offer the most resistance. The opinion of the Finance Minister, Mr. Mustafa Jassim Al-Shemali, is unknown. Though a former Under Secretary at the Finance Ministry, he has been out of government for over a year. Post will raise the issue with him at the earliest opportunity.

¶17. (U) McCormick was accompanied to his meetings by Director of the Office of Middle East and North Africa Karen Mathiasen, Senior Advisor Sonja Renander, Chief Economist Marvin Barth, Public Affairs Specialist Ann Marie Hauser, as well as CDA, and Econoff. Under Secretary McCormick cleared this cable.

¶18. (U) Under Secretary McCormick cleared this cable.

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